Berle and the Entrepreneur

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I. Introduction

In the first and last four chapters ("the Five Chapters") of *The Modern Corporation and Private Property*,[1] Adolf Berle, Jr. describes in sweeping terms a fundamental transformation of the American economy.[2] At the beginning of the nineteenth century, the dominant economic actor was the sole proprietor, who owned and controlled all aspects of his business. By the first quarter of the twentieth century, the "corporate system,"[3] and the few hundred large, quasi-public corporations of which it was composed, had taken control of many sectors of American industry and promised in years to come to gain an increasingly larger share of America's economic wealth and power.[4] Berle identified separation of ownership from control as the central characteristic of the corporate system and its constituent corporations.[5] Shareholders supplied the wealth but none of the control. Managers exercised control but took none of the risks. As a result, Berle asserted, one of the fundamental assumptions underlying our system of private property no longer held true. In the early nineteenth century, we believed that allowing the businessman to

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1. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 340–41 (MacMillan 1933).

2. Berle's co-author was Gardiner Means. However, Berle is acknowledged as the principal author and overall project director. *See* ADOLF A. BERLE, NAVIGATING THE RAPIDS, 1918–1971, FROM THE PAPERS OF ADOLF A. BERLE 20–21 (Beatrice Bishop Berle & Travis Beal Jacobs, eds., 1973) [hereinafter BERLE, NAVIGATING THE RAPIDS]. The Five Chapters bear Berle's unmistakable mark, containing two themes that continued throughout the remainder of his career: an emphasis on the problem of power and a focus on bringing the reality of America more in line with its ideology. *See infra* notes 90–94, 107–123 and accompanying text.

3. BERLE & MEANS, *supra* note 1, at 1, 2–4.

4. *Id.* at 2–3, 10–19.

5. *Id.* at 4–7.

use his property as he saw fit was socially efficient because, in the pursuit of maximum profit, each businessman would find it in his best interest to allocate resources effectively. In this early nineteenth century world, the businessman was a sole proprietor—an entrepreneur—and he owned and controlled the business. He took the consequences, good (profits) or bad (losses), resulting from his operation of the business.[6] Berle referred to this as "the traditional logic of profits."[7] But in the world of the modern corporation Berle described, ownership and control had been separated, undercutting the traditional logic of profits that had justified the laissez-faire reliance on private property.[8] This raised the specter of the concentration of enormous power in the hands of a few hundred captains of industry; uncontrolled by the profit motive or by the shareholders, these captains of industry would inevitably take for themselves powers akin to that of princes to be used for ends of their own choosing.[9]

Viewed from today, and through a lens dominated by the thinking and ideology of neo-classical economists identified with the University of Chicago,[10] Berle's critique appears in substantial part to claim that the modern corporation is not operated as if by a classic entrepreneur with the goal of maximizing shareholder wealth. So viewed, Berle's critique reduces to an empirical question: do the managers of the modern corporation make decisions substantially similar to those that would be made by a true entrepreneur? If managers act substantially as would a true owner/entrepreneur, and if the price a shareholder pays for her stock reflects the value of the expected efforts of the managers and not the value of the effort that would be expected if the managers owned 100% of the firm's equity, then separation of ownership and control is an illusory problem.

Writing more than ten years before Berle, another seminal scholar, Frank Knight,[11] addressed this empirical question. In *Risk, Uncertainty and Profit*,[12] Knight developed a theory of the entrepreneur as part of his larger effort to more carefully explain the theoretical underpinnings of a free-market economy.[13] In this work, still considered the leading expli-

6. *Id.* at 8.

7. *Id*. at 33–44.

8. *Id.*

9. BERLE & MEANS, *supra* note 1, at 2, 354–55.

10. On the characteristics and nature of the "Chicago School of Economics," see H. Laurence Miller, Jr., *On the "Chicago School of Economics*,*"* 70 J. POL. ECON. 64 (1962).

11. Readers less familiar with Frank Knight may find useful biographical references *infra*, notes 47–56 and accompanying text.

12. FRANK H. KNIGHT, RISK, UNCERTAINTY AND PROFIT (Houghton Mifflin 1921).

13. Frank Knight's *Risk, Uncertainty and Profit* serves as an important bridge between classical and neo-classical economics and between an economics devoid of interest in the firm to the mod-

cation of the role of the entrepreneur, Knight agreed with Berle that unification of ownership and control was essential to the proper functioning of a free-market economy. However, Knight presented a compelling argument that the modern corporation was controlled and operated by one or more persons who managed the firm in a fashion similar to the classical entrepreneur.[14]

By the time Berle began working on *The Modern Corporation and Private Property*, Knight and *Risk, Uncertainty and Profit* were at the center of debate about economic theory.[15] Given Knight's prominence and the fact that Knight apparently reached dramatically different conclusions than did Berle concerning the consequences flowing from separation of ownership and control, it is initially surprising to discover that Berle did not directly cite or acknowledge Knight or his work. However, I will show that not only was Berle familiar with Knight's work and theories, but also that the Five Chapters can be read and understood as intended, in part, as Berle's response to Knight's theories. This reading of Berle is hidden from view by our misunderstanding of historical context.

More broadly, I will show that the lens of today results in a distorted view of what motivated Berle and what he was attempting to argue and accomplish in his writing of *The Modern Corporation and Private Property*. As Berle wrote the Five Chapters, he was increasingly strad-

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ern focus on developing a theory of the firm. Knight had two overarching goals. First, he sought to bring coherence to the historic body of theoretical economics, thereby completing the classical economists' perfect competition theory project. Knight explained that objective as follows:

> The aim will be to bring out the content of the assumptions or hypotheses of the historic body of economic thought, referred to by the classical writers as 'natural price' theory. This is meant, not as the assumptions definitely in the minds of the classical economists, but the assumptions necessary to define the conditions of perfect competition, at which the classical thought was aimed, and which are significant as forming the limiting tendency of actual economic processes.

Id. at 18. Second, he sought to go beyond perfect competition theory to provide a coherent theory of imperfect competition—how the free enterprise system actually works. *Id.* at 179–375. Central to that task was an understanding of uncertainty and its consequences.

> When uncertainty is present and the task of deciding what to do and how to do it takes the ascendancy over that of execution, the internal organization of the productive groups is no longer a matter of indifference or a mechanical detail. Centralization of this deciding and controlling function is imperative, a process of 'cephalization,' such as has taken place in the evolution of organic life, is inevitable, and for the same reasons as in the case of biological evolution.

Id. at 268–69. In carrying out this sweeping agenda, Knight necessarily focused on the fundamental nature of the economic system and the ways in which actual economic organizations—what Coase later called firms—differ from the economic organizations that would exist under perfect competition. *Id.* at 264–312, 349–68.

14. Charles R. T. O'Kelley, *The Entrepreneur and the Modern Corporation*, 31 J. CORP. L. 753, 766–72 (2006).

15. *See infra* notes 49–52 and accompanying text.

dling the worlds of theory and practice. He and other public intellectuals were struggling to overcome the prevailing myth of individualism that blocked the road to a needed reshaping of the institution of private property and a needed adjustment in the national government's economic role. Berle saw himself playing a lead role in paving the way for what was to become known as the New Deal. He saw *The Modern Corporation and Private Property*, and particularly the Five Chapters, as the centerpiece of a new interpretation of the myth of individualism; he envisioned the revised myth as the cornerstone upon which the New Deal would be erected. To accomplish his myth-making goals, Berle chose to identity the myth of individualism in the Five Chapters with the work of Adam Smith, rather than the work of Frank Knight. I will explain why Berle made this choice and explore the consequences.

The article proceeds as follows. In Part II, I summarize the standard reading of the Five Chapters, an interpretation that is distorted by a failure to consider the context within which Berle wrote. In Part III, I present a standard summary of Frank Knight's free-market theories. In Part IV, I address the question of how familiar Berle was with Knight's work. In Part V, I present an interpretation of the Five Chapters as a response to Frank Knight. I conclude with some observations concerning perhaps surprising similarities in the views of Knight and Berle and provide a suggestion for how the collective research agenda of corporation law scholars might be reoriented in order to deepen and enrich our ongoing study of the corporation, law, and society.

II. THE STANDARD READING OF THE FIVE CHAPTERS

In the Five Chapters,[16] Adolf Berle paints a compelling account of the death of an economic system dominated by the individual entrepreneur and the ascendancy of a new corporate system dominated by the modern corporation and its faceless managers. The old, nineteenth century economic order featured numerous small firms, most of which were owned by a sole proprietor. The governing economic and political ideology of this period—classic liberalism—idealized the individual and the so-called "free-market" economy commonly identified with Adam Smith's "invisible hand." Liberalism relegated government to the limited role of protecting the individual's right to own private property and use it in the pursuit of the individual's self-interest. In the ideology of free-market capitalism, individual consumers and producers govern the economy. Each consumer and producer independently sends and responds to price signals concerning available products and services.

16. BERLE & MEANS, *supra* note 1, at 1–9, 333–57.

Each producer and consumer autonomously and freely calculates and decides what to buy and sell. The result is the best possible allocation of economic resources.[17]

On the production side of the equation, the central actor was the individual entrepreneur. She put at risk her wealth, dedicating it to the ownership of the firm's plant and machinery and to guaranteeing the payment of monies promised to employees and other creditors. She also put at risk her own human capital—her sweat equity—dedicating it to the task of managing the firm. Her reward (at least if the venture was successful) was the firm's profits.[18]

Unification of ownership and control in the individual entrepreneur was the linchpin of free-market ideology, and it also served as the underlying justification for protecting the entrepreneur's wealth and ownership rights. Society as a whole, as well as persons working for the entrepreneur, could rationally believe that the entrepreneur, spurred by her desire for personal gain, would make business decisions intended to achieve the highest and best use of her business property. While some entrepreneurs would succeed and others fail, the sum of all entrepreneurs' business judgments and actions would produce the best allocation of societal resources consistent with a free and just society.[19]

Berle's claim was straightforward: the modern corporation and its separation of ownership and control undermined the ideology of capitalism and the rationale for protecting private property in the means of production.

> It has been assumed that, if the individual is protected in the right both to use his own property as he sees fit and to receive the full fruits of its use, his desire for personal gain, for profits, can be relied upon as an effective incentive to his efficient use of any industrial property he may possess.
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> In the quasi-public corporation, such an assumption no longer holds. As we have seen, it is no longer the individual, himself, who uses his wealth. Those in control of that wealth, and therefore in a position to secure industrial efficiency and produce profits, are no longer as owners entitled to the bulk of such profits. . . . The explosion of the atom of property destroys the basis of the old assumption that the quest for profits will spur the owner of industrial property to its effective use.[20]

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17. O'Kelley, *supra* note 14, at 757; *infra* notes 95–96 and accompanying text.
18. KNIGHT, *supra* note 12, at 271–90.
19. BERLE & MEANS, *supra* note 1, at 340–41, 8–9.
20. *Id.* at 8–9.

Under the standard reading of the Five Chapters, separation of ownership and control adversely affects two groups: society as a whole indirectly and shareholders directly.[21] Society as a whole loses because resources are not allocated to their highest and best use. Shareholders lose because the corporation is not operated for their exclusive benefit:

> It is traditional that a corporation should be run for the benefit of its owners, the stockholders, and that to them should go any profits which are distributed. We now know, however, that a control group may hold the power to divert profits into their own pockets. There is no longer any certainty that a corporation will in fact be run primarily in the interests of the stockholders.[22]

What is to be done about separation of ownership and control? Berle sketched three possibilities. On the one hand, we could attempt to make the traditional logic of profit work by bringing social and legal pressure to bear "in an effort to insure corporate operation primarily in the interests of the 'owners' . . . ."[23] Alternatively, society could recognize the managerial control group as the new owners of the firm; the managerial control group would be entitled to exercise unfettered power over the corporation and to receive the profits of the firm as an incentive to ensure that resources were allocated to their highest and best use. The third alternative was to subordinate the claims of both ownership and control to the larger interests of society.[24]

The standard reading of the Five Chapters places heavy emphasis on the assertion that the modern corporation is no longer being operated for the exclusive benefit of the shareholders.[25] If that problem could be easily solved, then society would once again be able to rely on the traditional logic of profits and the institution of private property. So viewed, it appears that Berle makes an empirical claim that separation of ownership and control has robbed society and shareholders of the benefits that otherwise would accrue from the workings of the free-enterprise system. From the standpoint of traditional microeconomic theory, it appears that Berle is asserting that separation of ownership and control has resulted in the replacement of the classic entrepreneur with a managerial control

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21. William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation*, 34 J. CORP. L. 99, 101 nn.4–5 (2008). Bratton and Wachter, however, develop a contextual and nuanced reading of Berle's work, showing the evolution in his thinking and the shifting historical context in which he thought and wrote. *Id.* They argue that *The Modern Corporation and Private Property* reflected Berle's views at the midpoint of his transformation from corporate lawyer to corporatist. *Id.* at 118–23.

22. BERLE & MEANS, *supra* note 1, at 333.

23. *Id.*

24. *Id.* at 333, 356.

25. *Id.* at 333.

group that is not motivated by the traditional logic of profits. Finally, Berle appears to believe that "fixing" the problem is not feasible.[26] If these empirical claims are false, then the problem of separation of ownership and control turns out to be "a tale . . . full of sound and fury, signifying nothing."[27]

III. FRANK KNIGHT—THE ENTREPRENEUR STILL REIGNS WITHIN THE MODERN CORPORATION

The standard account of the Five Chapters stands in stark contrast to Frank Knight's explanation of the role of the entrepreneur and the phenomenon of separation of ownership and control. In *Risk, Uncertainty and Profit*,[28] Knight developed a theory of the entrepreneur that ranks even today as the seminal text on that subject.[29] Knight's account explained the unique, creative function played by the entrepreneur in dealing with uncertainty.[30] Importantly, Knight identified unification of ownership and control as central to the entrepreneur's ability to function.[31] However, unlike Berle, Knight argued that the modern corporation was operated as if by a classical entrepreneur.

Knight viewed "the entrepreneur system of organization, with production for the market impersonally, and concentration of direction" as the defining characteristic of the real world free-enterprise system.[32] Like Berle, Knight understood the role played by the prototypical entrepreneur—the sole proprietor. Indeed, Knight systematically modeled that role, concluding that the entrepreneur carries out two key functions: she manages—that is, she determines what products will be produced—and she assumes the risk of her decisions—that is, she puts her personal wealth at risk as a means of guaranteeing to her employees that even if the venture fails, they will receive the compensation for which they bargained.[33] In other words, the entrepreneur was not an individual who simply charted a firm's course in return for a salary. Rather, the entre-

26. Berle did not think the problem could be easily solved, if at all. *See id.* at 342–44.

27. WILLIAM SHAKESPEARE, MACBETH act 5, sc. 5.

28. *Risk, Uncertainty and Profit* is the final version of Knight's doctoral thesis, completed in 1916 while a graduate student at Cornell University. 1 FRANK H. KNIGHT & ROSS B. EMMETT, SELECTED ESSAYS BY FRANK H. KNIGHT, at viii. (Ross B. Emmett, ed., Univ. of Chi. Press, 1999).

29. *See* S. Ramakrishna Velamuri & S. Venkataraman, *Why Stakeholder and Stockholder Theories are not Necessarily Contradictory: A Knightian Insight*, 61 J. BUS. ETHICS 249, 251–62 (2005); Nicolai Juul Foss, *More on Knight and the Theory of the Firm*, 14 MANAGERIAL & DECISION ECON. 269 (1993); Arthur H. Leigh, *Frank H. Knight as Economic Theorist*, 82 J. POL. ECON. 578 (1974).

30. KNIGHT, *supra* note 12, at 264–76.

31. *Id.* at 349–53.

32. *Id.* at 351.

33. *Id.* at 270.

preneur was the person who specialized in "responsible direction."[34] By owning the firm, she put both her wealth and human capital at risk. Thereby, the entrepreneur was taking responsibility for her business judgments.

Like Berle, Knight understood that the modern corporation presented a phenomenon that must be woven into the fabric of the neoclassical account of the modern market economy, if that account were to remain relevant.[35] Knight acknowledged that the modern corporation with its salaried manager and apparently powerless shareholders seemed to be an institution in which ownership had been separated from control and thus, an institution operating without an entrepreneur. Knight asserted, however, that an empirical analysis of actual corporations, coupled with an understanding of the psychological make-up of entrepreneurs,[36] would reveal that ownership and control remained effectively unified in the modern corporation.[37]

Interestingly for corporation lawyers and scholars seeking insight about the judicial abstention doctrine modernly termed the "business judgment rule," Knight believed that a proper understanding of the nature of business judgment would lead to a discovery that the modern corporation was actually managed and controlled by an approximation of the classic entrepreneur.[38]

> The first necessary step in understanding the distribution of control and responsibility in modern business is to grasp this fact: What we call 'control' consists mainly of selecting someone else to do the 'controlling.' Business judgment is chiefly judgment of men. We

34. *Id.* at 271.

35. Frank Knight understood that "[t]he typical form of business unit in the modern world is the corporation. Its most important characteristic is the combination of diffused ownership with concentrated control." KNIGHT, *supra* note 12, at 291. Further, he noted:

> Most [shareholders in the modern corporation] do not regard themselves and are not regarded as owners of the business. In form they are owners, but in substance they are merely creditors, and both they and the insiders count upon the fact. The great companies are really owned by small groups of men who generally know each other's personalities, motives and policies tolerably well.

Id. at 359.

36. *See infra* text accompanying notes 41–44.

37. KNIGHT, *supra* note 12, at 291–99. "The apparent separation between ownership and control turns out to be illusory." *Id.* at 297. "Whenever we find an apparent separation between control and uncertainty—bearing, examination will show that we're confusing essentially routine activities with real control." *Id.* at 298.

38. I have argued elsewhere that Knight's theory of the entrepreneur and what I call "entrepreneur primacy" provide a basis for understanding the business judgment rule and other important corporation law cases and doctrines. *See* O'Kelley, *supra* note 14.

> know things by knowledge of men who know them and control things in the same indirect way. . . .[39]
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> There is an apparent separation of the functions of making decisions and taking the 'risk' of error in decisions. The separation appears quite sharp in the case of the hired manager, as in a corporation, where the man who makes decisions receives a fixed salary, taking no 'risk,' and those who take the risk and receive profits—the stockholders—make no decisions, exercise no control. Yet a little examination in the light of the preceding discussion of indirect knowledge and indirect responsibility will show that the separation is illusory; when control is accurately defined and located, the functions of making decisions and assuming the responsibility for their correctness will be found to be one and indivisible.[40]

Finally, Knight believed that the psychological make-up of the entrepreneur provided the ultimate assurance that the apparent separation of ownership and control would not interfere with the operation of the corporation primarily for the benefit of the shareholders. "[Entrepreneurs] are not the critical and hesitant individuals, but rather those with restless energy, buoyant optimism, and large faith in things generally and themselves in particular . . . ."[41] "Most human motives tend on scrutiny to assimilate themselves to the game spirit. It is little matter, if any, what we have set ourselves to do . . . . But once having set ourselves to achieve some goal it becomes imperative to achieve it."[42] In Knight's view then, the typical entrepreneur sets a goal of pursuing maximum profits for the corporation and its shareholders and pursues that goal as if a game, with the boundless energy and enthusiasm that only a true entrepreneur possesses.[43]

> For it is clear that the 'personal' interests which our rich and powerful businessmen work so hard to promote are not personal interests at all . . . . The real motive is the desire to excel, to win at a game, the biggest and most fascinating game yet invented, not excepting even statecraft and war.[44]

Thus, Knight's account presented for empirical testing the proposition that the entrepreneur still reigns within the modern corporation and

39. KNIGHT, *supra* note 12, at 291–92.

40. *Id.* at 293–94.

41. *Id.* at 366.

42. *Id.* at 53.

43. Berle accepted the possibility that the control within the modern corporation might be properly motivated by a very small percentage of the firm's profits. BERLE & MEANS, *supra* note 1, at 343–44.

44. KNIGHT, *supra* note 12, at 360.

that the modern corporation is in fact operated primarily for the benefit of the shareholders. It laid the groundwork for the voluminous contractarian accounts of the corporation birthed by law and economics scholars in the last quarter of the twentieth century, the most important of which[45] makes the case that shareholders and managers bargain for corporate governance rules ensuring that the modern corporation is operated primarily in the interest of shareholders.[46] Thus, if one accepts Knight's account, or the modern contractarian account, Berle's identification of the rise of the corporate system and the attendant separation of ownership and control as a paradigm-shifting event seems to have missed the mark. At most, separation of ownership and control (and the threat it poses to the incentives provided by the profit motive) is a technical problem to be solved by private contracting and appropriate government regulation of the securities markets. However, it does not appear to represent or require a fundamental break with the laissez-faire system of private property and the individualist ideology associated therewith.

IV. BERLE'S FAMILIARITY WITH THE WORK OF FRANK KNIGHT

A surface reading of *The Modern Corporation and Private Property* discloses no direct citation to Frank Knight's *Risk, Uncertainty and*

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45. The foundational works in this regard are Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 289–90 (1980).

46. Modernly, principal-agent theorists have argued persuasively that shareholders and managers do in fact contract for corporate governance systems that provide managers with strong incentives to operate the firm as would a true entrepreneur and that shareholders discount what they pay for shares to reflect any residual loss that still can be expected to occur. Owner/managers who sell shares to outsiders want to minimize the discount that purchasers will demand for anticipated shirking—actions taken that deviate from what the manager would do if he or she were still the owner of 100% of the business, and thus still fully motivated by the traditional desire to maximize profits. Thus, managers voluntarily and in agreements with purchasers supplement the restraints provided by corporation and securities laws with private-ordering mechanism designed to optimally minimize the cost of anticipated future shirking. Whatever anticipated residual loss from shirking remains will result in a corresponding reduction in the price at which the manager can sell shares to outsiders.
The most illuminating example is an initial public offering by a corporation sole. Before the public offering, the sole shareholder is the sole residual claimant and will bear fully the impact of her non-shareholder-wealth-maximizing behavior as a manager. Thus, the owner can be expected to respond as a classical entrepreneur in making resource allocation decisions. After selling a portion of her shares, however, the former sole shareholder will only bear a portion of the cost of her non-shareholder-wealth-maximizing behavior as a manager. If the owner/manager could shift the cost of such post-sale shirking to prospective shareholders, then separation of ownership and control would be a serious problem. But she cannot, because the prospective purchaser will discount for the probability of such misconduct. Instead, the Seller willingly takes contractual steps to ensure prospective purchasers that shirking will be optimally minimized and accordingly, that the manager will continue to act similarly to a classical entrepreneur.

Profit. However, a consideration of Berle's intellectual connections with academics in the field of economics, the prominence of Knight and his work in those circles, and a careful read of the scholarly work Berle cited in the Five Chapters, leaves no doubt that Berle was intimately familiar with Knight's work and his theories about the role of the entrepreneur.

Without question, "Knight was 'the dominant intellectual in influence' in the economics department at the University of Chicago [between World War I and World War II], and, arguably the most important non-Keynesian American economist of his generation."[47] From 1917 to 1919, he taught at the University of Chicago as an instructor. After an eight-year stint at the University of Iowa, he returned to the University of Chicago in 1928, where he remained for twenty-five years.[48] Knight and his work, particularly *Risk, Uncertainty and Profit*, were at the center of scholarly debate about the workings of the modern economy during the 1920s and early 1930s. For example, while a student at the London School of Economics between 1929 and 1932, R.H. Coase worked on the first draft of his seminal article, *The Nature of the Firm*.[49] In the final version of that article, Coase devoted more text to an analysis of *Risk, Uncertainty and Profit* than to all of the other economic scholars he cited combined.[50] On the pervasiveness of Knight's intellectual influence during his time at the London School of Economics, Coase later commented:

> Knight's ideas were so much in the air at LSE . . . . Everyone at LSE referred to *Risk, Uncertainty and Profit* whether they had read it or not.[51]
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> [Knight] was regarded at the London School of Economics as one of the greatest of economists and his book, *Risk, Uncertainty and Profit*, was closely studied by all serious students of economic theory.[52]

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47. KNIGHT & EMMETT, *supra* note 28, at vii (quoting George J. Stigler, *Frank H. Knight*, 3 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 56 (John Eatwell, Murray Millgate & Peter Newman eds., 1987)).

48. *Id.* at 323. "Knight returned to Chicago in 1928 to take up the chair left vacant by J.M. Clark's departure for Columbia University." GEOFFREY M. HODGSON, THE EVOLUTION OF INSTITUTIONAL ECONOMICS: AGENCY, STRUCTURE, AND DARWINISM IN AMERICAN INSTITUTIONALISM 323 (Routledge 2004).

49. R.H. Coase, *The Nature of the Firm: Meaning* , 4 J.L. ECON. & ORG., 19, 20 (1988).

50. R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937). The article is nineteen full pages in length, plus a line or two. Coase devotes more than six of those pages exclusively to Knight and *Risk, Uncertainty and Profit*. *Id.* at 388, 392–95, 398–401.

51. Coase, *supra* note 49, at 20.

52. R.H. Coase, *Law and Economics at Chicago*, 36 J.L. & ECON. 239, 239 (1993).

But Knight's work during the time between the First World War and the New Deal was not limited to his path-breaking book. Between 1920 and 1933, Knight published at least fifty-three articles and reviews. During that period, Knight was heavily influenced by the work of Thorstein Veblen[53] and deeply interested in developing his own version of institutional economics.[54] Although today he is often, probably unfairly, labeled a neo-classicist, such label relates to Frank Knight's work occurring well after 1932. The Frank Knight who wrote and participated in scholarly dialog in the pre-New Deal decade was as much an institutionalist as a neo-classicist and was a member of the elite mainstream of academic economists, which group included in its number faculty members at both Harvard and Columbia with whom Berle had strong, direct connections.[55] Clearly anyone participating in debates within the field of economics during the 1920s and early 1930s, and particularly anyone involved in the scholarly life of the leading university departments of economics, would be intimately familiar with Knight and his theory of the entrepreneur.[56]

Berle fits the bill of someone who would have been expected to know of Frank Knight and his work. Berle was intensely interested in learning more about economics, particularly as it related to corporations. His study of corporation law in the early 1920s showed him the limitation of seeking to understand the intricacies of business from the study of appellate decisions. As he noted, "Corporate transactions and financial methods are invariably some years ahead of court interpretations."[57] Accordingly, Berle created opportunities to mingle with and learn from scholars in the field of economics. This effort led Berle "far afield; and it resulted in two years' traveling to the Graduate School of Business Administration at Harvard, nominally for the purpose of teaching the subject of corporation finance, but actually for the purpose of becoming

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53. While an instructor at Chicago from 1918 to 1920, Knight "was an influential member of a group that gathered together to read and discuss Thorstein Veblen's works." HODGSON, *supra* note 48, at 323.

54. KNIGHT & EMMETT*, supra* note 28, at xiii, xv.

55. Those closest to Berle included William Z. Ripley, Gardiner Means, and Rexford Tugwell, all of whom, like Frank Knight, were institutionalists influenced by Thorsten Veblen. Thomas K. McCraw, *In Retrospect: Berle and Means*, 18 REVS. AM. HIST. 578, 580 (1990); Rexford G. Tugwell, *The New Deal: The Progressive Tradition*, 3 W. POL. Q. 390, 406–10, 412, 423 (1950); Malcolm Rutherford, *Institutional Economics: Then and Now*, 15 J. ECON. PERSP. 173, 179 (2001).

56. During the decade preceding the Great Depression as now, American university departments of economics had different emphases, with the most influential schools being institutionalism and neo-classicism. Frank Knight and his work cut across these lines. *See* HODGSON, *supra* note 48, at 323–24; Ross Emmett, "Frank Knight, Max Weber, Chicago Economics, and Institutionalism," *in* ROSS EMMETT, FRANK KNIGHT AND THE CHICAGO SCHOOL IN AMERICAN ECONOMICS 112-123 (2009).

57. ADOLF A. BERLE, JR., STUDIES IN THE LAW OF CORPORATE FINANCE vi (1928).

better acquainted with financial theory."[58] Berle used his time at Harvard well. While attending Harvard College, Berle had been a student of William Z. Ripley, a prominent professor of economics. During his teaching stint at Harvard, Berle renewed his relationship with Ripley, who subsequently cited Berle's work on corporate law in Ripley's influential book, *Main Street and Wall Street*.[59] Ripley was later influential in helping Berle obtain funding for the study-of-corporations project that would culminate with the publication of *The Modern Corporation and Private Property*.[60] One thing led to another. The funding of the study-of-corporations project led to Berle joining the faculty at Columbia Law School and to his hiring of Gardiner Means, then a graduate student in economics at Harvard, as a statistical and economics research assistant.[61] Both Ripley and Means were institutionalists, strongly influenced by Veblen.[62] As Berle's citations of Veblen show, Berle also was influenced by Veblen.[63] Thus, through all of these associations and his own institutionalist leanings,[64] Berle was exposed to an environment similar to that experienced by R.H. Coase at the London School of Economics—an environment in which the work of Frank Knight took center stage.[65]

We are not left to surmise as to Berle's familiarity with Frank Knight's work however. A careful reading of the footnotes in *The Modern Corporation and Private Property* tells the tale. Most of *The Modern Corporation and Private Property* is heavily footnoted. The Five Chapters are starkly different; the footnotes are few, and only four scholars are directly cited. Three of the cited scholars—Adam Smith,[66]

58. *Id.* at vii.

59. Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247 (2010). *See* WILLIAM Z. RIPLEY, MAIN STREET AND WALL STREET 60, 92, 122 (1927).

60. BERLE, NAVIGATING THE RAPIDS, *supra* note 2, at 20; Wells, *supra* note 59, text accompanying notes 226–29.

61. BERLE, NAVIGATING THE RAPIDS, *supra* note 2, at 21.

62. Rexford G. Tugwell, *The New Deal: The Progressive Tradition*, 3 W. POL. Q. 390, 406–10, 412, 423 (1950); Malcolm Rutherford, *Institutional Economics: Then and Now*, 15 J. ECON. PERSP. 173, 179 (2001).

63. *See infra* notes 68, 71–74.

64. Richard S. Kirkendall, *A.A. Berle, Jr. Student of the Corporation 1917–1932*, 35 BUS. HIST. REV. 43, 58 (1961); Rick Tilman, *Apology and Ambiguity: Adolf Berle on Corporate Power*, 8 J. ECON. ISSUES 111, 111 (1974) ("Adolf A. Berle, Jr . . . must be considered at least a first cousin of institutional economists who compose the membership of the Association for Evolutionary Economics . . . . His critique of neoclassicism and his emphasis on the evolution of economic institutions is markedly similar to that of other institutional economists of his generation.").

65. On the environment at Columbia, see Malcolm Rutherford, *Institutional Economics at Columbia University*, 36 HIST. POL. ECON. 31, 31–52 (2004). On the environment at Harvard, see Valdemar Carlson, *The Education of an Economist Before the Great Depression: Harvard's Economics Department in the 1920's*, 27 AM. J. ECON. & SOC. 101 (1968).

66. Adam Smith, author of the *The Wealth of Nations* (1776), is now, and was at time Berle wrote, considered to be "the father of political economy." Amy Hewes, *Economic Myths*, 4 SOC.

Walther Rathenau,[67] and Thorstein Veblen[68] were and remain important in the history of economic thought. By citing each of these scholars,

SERVICE REV. 23, 27 (1930). He was also identified with the "invisible hand" explanation of free markets.

> It was Adam Smith who first pointed out the fundamental role to be played by profits . . . in a capitalist economy: each individual's actions are motivated by the desire for gain. Profits, that is, are the motive force behind economic decisions. Furthermore, the pursuit of self-interest leads the individual by "an invisible hand" to promote social benefit from which springs the conventional wisdom among orthodox economists that capitalist market economies function, theoretically, in a manner superior to planned socialist economies.

Mark Obrinsky, *The Profit Profits*, 3 J. POST KEYNESIAN ECON. 491, 491 (1981).

67. Walther Rathenau was a German industrialist, politician, and social critic whose books and pamphlets were widely read in the aftermath of World War I. W.O Henderson, *Walther Rathenau: A Pioneer of the Planned Economy*, 4 ECON. HIST. REV. 98, 98–99 (1951). His work included a detailed criticism of late capitalism that shared much in common with the work of Thorstein Veblen. *See* WALTHER RATHENAU, IN DAYS TO COME, 25–128 (Eden & Cedar Paul, trans., 1921) [hereinafter RATHENAU, DAYS TO COME]. However, he is most remembered as the father of economic planning and the planned economy. Henderson, *supra*, at 98–108; Arnold Brecht, *Walther Rathenau and the German People*, 10 J. POL. 20, 34 (1948). It seems likely that Berle viewed Rathenau as a kindred spirit on multiple levels. Both Berle and Rathenau had strict fathers who demanded excellence. Both men had difficulty working with others and assumed leadership roles because of the strength of their intellect, imagination, and capacity for hard work. Both men were that rare combination—doers and dreamers. John McCarten, *Profiles: Atlas with Ideas—Part II*, NEW YORKER, Jan. 23, 1943, at 22–24 [hereinafter McCarten II]; Brecht, *supra* at 31; HARRY KESSLER, WALTHER RATHENAU: HIS LIFE AND WORK, 7–8, 24 (Beston Press, 2008) (1928). "There is no intellectual in the world to whom [Rathenau] would not have measured up in conversation or in writing." Brecht, *supra* at 36. Both men understood persecution. Berle, as an American of Germanic descent, felt its sting while an undergraduate at Harvard during World War II, for failing to change his name or join in anti-German manifestos. BERLE, NAVIGATING THE RAPIDS,*supra* note 2, at 5. Rathenau "often complained that he was only 'a second-class citizen'—unable in peacetime to aspire to the rank of lieutenant in the Prussian army." Henderson, *supra* at 102 (internal citation omitted). In 1922, while serving as Germany's foreign minister, Rathenau was assassinated solely because he was a Jew by individuals who wrongly doubted his patriotism. Brecht, *supra*; WALTHER RATHENAU, INDUSTRIALIST, BANKER, INTELLECTUAL, AND POLITICIAN: NOTES AND DIARIES 1907–1922, at 10–11 (Hartmut Pogge von Strandmann ed., Caroline Pinder Cracraft trans., Oxford 1985) (1967) [hereinafter RATHENAU, INDUSTRIALIST, BANKER, INTELLECTUAL, AND POLITICIAN]. It is likely that the young Berle saw much of himself as he hoped to be in Rathenau, who in 1909 was described as "one of 'the 300 men, each knowing all the others, who together control the economic destiny of the Continent.'" Henderson, *supra* at 98 n.4. Berle was largely to realize that hope as one of Roosevelt's key advisors and confidants. In reflecting on the role that he and a handful of others played, Berle later noted, "[i]rrespective of [history's verdict as to our importance] we can comfort ourselves with consciousness that high privilege and great good fortune allowed us to be among the many coworkers in a time of vast change." BERLE, NAVIGATING THE RAPIDS, *supra* note 2, at 115. In that modest reflection, I imagine Adolf Berle saw himself as having successfully followed in the footsteps of Walther Rathenau.

68. Thorstein Veblen "was arguably the most original and penetrating economist and social critic that the United States has produced." RICK TILMAN, THORSTEIN VEBLEN AND HIS CRITICS, 1891–1963, at ix (Princeton 1992). At the time Berle wrote the Five Chapters, Veblen was acknowledged to be the father of American institutional economics. "Perhaps the critical question which Veblen asked was, 'Why is economics not an evolutionary science?' The attempted answer included, negatively, an attack upon the scientific validity of systematic economic theory as currently expounded and constructively, the outlines of an evolutionary and institutional explanation of

Berle was, of course, signaling his awareness of the important bodies of economic thought with which each man was associated. But, he was signaling much more. The repeated citation[69] and criticism of Adam Smith placed Berle in the mainstream of scholars and business leaders who viewed laissez-faire individualism as a doctrine unsuited for the modern era.[70] By citing Veblen,[71] Berle paid tribute to the acknowledged

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economic behavior." Paul T. Homan, *An Appraisal of Institutional Economics*, 22 AM. ECON. REV. 10, 10 (1932). Moreover, it was already clear that Veblen had lived a life as a scholar and writer that would be judged kindly by history. As noted in celebration of the 100th anniversary of Veblen's birth: "Some men effectively catch the drift of development and have a vision of things to come. Such men become active forces in that very development and their names become landmarks and turning points. Time alone is the final judge of a candidate's right to inclusion in this select list. For, Veblen, time has rendered its verdict . . . ." Joseph Dorfman, *Source and Impact of Veblen*, 48 AM. ECON. REV. 1, 1 (1958).

Like Veblen, Berle caught the drift of things to come. Veblen had near encyclopedic knowledge of western culture and command of several languages. Rick Tilman & Andrea Fontana, *Italian Debate and Dialogue on Thorstein Veblen: The Evolution of Appreciation for His Contributions Despite the Apathy of the Intelligentsia*, 44 AM. J. ECON. & SOC. 81, 88 (1985); RICK TILMAN, THORSTEIN VEBLEN, JOHN DEWEY, C. WRIGHT MILLS AND THE GENERIC ENDS OF LIFE, 3–4 (Rowman & Littlefield Publishers 2004).

Berle was not far behind. Like Berle, Veblen was deeply interested in understanding the modern corporation and its impact on society and, like Berle, Veblen saw corporate finance as the key to understanding the imperatives of the emerging corporate system.

Despite their similarities of insight and intellect, Veblen and Berle had very dissimilar life experiences. Berle was rooted in urban America and graduated from Harvard Law School at age sixteen. He immediately entered the world of the power elite as a Wall Street lawyer, academic, and public servant, and spent his life working with and near members of the power elite. John McCarten, *Profiles: Atlas with Ideas—Part I*, NEW YORKER, January 16, 1943 [hereinafter McCarten I]. Veblen was raised on farms in near isolation from American society. His parents had emigrated from Norway ten years before Veblen's birth. His father never learned English. Veblen had great difficulty obtaining and keeping academic posts and lived much of his later life without formal employment. RICK TILMAN, THORSTEIN VEBLEN AND THE ENRICHMENT OF EVOLUTIONARY NATURALISM 1–2 (2007). In sum, Veblen "was a loner and academic drifter." Marc R. Tool, *An Institutionalist Legacy: Remarks upon Receipt of the Veblen-Commons Award*, 23 J. ECON. ISSUES 327, 327 (1989). Despite Veblen's inability to fit comfortably into elite society, he had an enormous influence on those he taught, directly and indirectly.

69. The entirety of Book 4, Chapter 3, "The Inadequacy of Traditional Theory," is devoted to a critique of Adam Smith and the economic theories Berle attributed to Smith. *See* BERLE & MEANS, *supra* note 1, at 345–51. Additionally, Berle cites Adam Smith and *The Wealth of Nations* on the first page of Book 4, Chapter 2, "The Traditional Logic of Profits." *Id.* at 340.

70. As the Great Depression deepened, American businessmen rapidly abandoned their resistance to government intervention. "By 1932 the American business community—or, at least, powerful elements in it—was moving fast towards ideas of central economic planning. The nation, said a Vermonter, Ralph E. Flanders of the Jones and Lamson Machine Company, was approaching a new stage in human development—'the self-conscious direction of the mechanism of economic and social life to ends of general well-being. . . . American business, as Henry I. Harrison summed it up, was coming to accept 'the philosophy of a planned economy.'" ARTHUR M. SCHLESINGER, JR., THE CRISIS OF THE OLD ORDER, 1919–1933, at 183 (1957).

71. The very first citation in *The Modern Corporation and Private Property* is to "Thorstein Veblen, *Absentee Ownership and Business Enterprise*, N.Y. 1923." BERLE & MEANS, *supra* note 1, at n. 1.

patron saint of those seeking to transform America in the aftermath of the Great Depression.[72] These citations also indicated Berle's agreement with Veblen's critique of late capitalism, including the significant role played by corporate finance in the control of the modern corporation[73] and the relationship between the modern corporation and the allocation of power in society.[74] By citing Rathenau,[75] Berle showed his belief in national economic planning, an idea championed by Rathenau both in theory and practice.[76] To readers having a deeper familiarity with Rathenau, Berle was also signaling his commitment to radical but incremental change,[77] his belief that the modern corporation should be trans-

72. The extent of Veblen's actual influence on the New Deal and its policies is debatable. RICK TILMAN, THE INTELLECTUAL LEGACY OF THORSTEIN VEBLEN: UNRESOLVED ISSUES 199–232 (Praeger 1996). His status as patron saint of those who molded the New Deal, as well as those who sought greater change, is not.

> To the young American radicals of the 1930s, Thorstein Veblen was a kind of patron saint. He was a home grown social theorist whose ironic thrusts at American capitalism seemed to grow more relevant in the chaos of depression. Every shade of leftist opinion could find something to admire in Veblen. . . . [M]any of his insights were common currency. Everybody was talking about "conspicuous consumption," "captains of industry," "robber barons," and even "pecuniary canons of taste." Veblen's odd but striking terminology provided many battle cries for the age.

George M. Fredrickson, *Thorstein Veblen: The Last Viking*, 11 AM. Q. 403, 403 (1959).

73. *See* Malcolm Rutherford, *Veblen on Owners, Managers, and the Control of Industry*, 12 HIST. POL. ECON. 434 (1980). Berle was likely drawn to this aspect of Veblen's work as a by-product of his own expertise in corporate finance. *See also* Forest G. Hill, *Veblen, Berle and the Modern Corporation,* 26 AM. J. ECON. & SOC. 279 (1967).

74. SIDNEY PLOTKIN, THORSTEIN VEBLEN AND THE REVIVAL OF FREE MARKET CAPITALSIM 171–72 (Janet Knoedler, Robert Prasch, Dell Champlin eds., 2007).

75. The second citation in *The Modern Corporation and Private Property* is to "Walther Rathenau, 'Die Neue Wirtschaft', Berlin, 1918," BERLE AND MEANS, *supra* note 1, at n.2. Rathenau is the only person referenced in the concluding chapter of the Five Chapters, entitled "The New Concept of the Corporation." Rathenau is referred to in the text of the first page of the concluding chapter, with a citation to "'Von Kommenden Dingen,' Berlin, 1918, trans. By E. & C. Paul, ('In Days to Come'), London, 1921, pp. 120, 121." *See* BERLE & MEANS, *supra* note 1, at 353.

76. W.O. Henderson, *Walther Rathenau: A Pioneer of the Planned Economy*, 4 ECON. HIST. REV. 98 (1951). In terms of Bratton and Wachter's reexamination of Berle, Bratton, and Wachter, *supra* note 19, Berle may also have been signaling his corporatist leanings. Rathenau was a leading proponent of corporatism, conceived of as a "perfectly tuned 'post-competitive industrial order.'" Diethelm Prowe, *Economic Democracy in Post-World War II Germany: Corporatist Crisis Response, 1945-1948*, 57 J. MODERN HIST. 451, 461 (1985) (citing CHARLES MAIER, RECASTING BOURGEOIS EUROPE: STABILIZATION IN FRANCE, GERMANY, AND ITALY IN THE DECADE AFTER WORLD WAR I, at 9–10 (Princeton, N.J. 1975)). *See also* RATHENAU, INDUSTRIALIST, BANKER, INTELLECTUAL, AND POLITICIAN, *supra* note 65, at 26. There are numerous definitions of the term "corporatism" and many different camps of corporatists. Given Berle's citation of Rathenau, it is interesting to see one author label Rathenau, Berle, and John Meynard Keynes as the leading members of the "technocratic, procapitalist reformism" wing of corporatism. Philippe C. Schmitter, *Still the Century of Corporatism?*, 36 REV. POL. 85, 87 (1974).

77. Rathenau advocated equalization of wealth, income, and educational opportunity; elimination of the right of personal inheritance; and heavy taxation of wasteful and luxury consumption. Henderson, *supra* note 65 at 104–105; RATHENAU, DAYS TO COME, *supra* note 67, at 111. Yet he

formed rather than destroyed,[78] and his commitment to the preservation of America's core political and social institutions.[79]

The fourth reference was to an article by S. H. Nerlove, *Recent Writings on Profits*.[80] Nerlove was unknown outside of academic circles. He joined the economics faculty at the University of Chicago in 1922, but when the department was split into economics and business administration, he joined the business side of the split.[81] Nerlove was intimately familiar with and favorably disposed to Berle's corporation law scholarship, which he cited not only in *Recent Writings on Profits* but also in an article published a year later, *Insiders and Corporate Income Streams*.[82] The scholar to whom Nerlove devoted the most text in *Recent Writings on Profits* was Frank Knight; the scholarly work to which Nerlove devoted the most text was Knight's *Risk, Uncertainty and Profit*.[83] The propositions for which Nerlove cited Knight predominantly related to Knight's analysis of perfect and imperfect competition and the role of the entrepreneur. By citing Nerlove, Berle was signaling his own familiarity with Knight's work, and giving clues as to how the Five Chapters could be read as a response to Knight's influential theories about the firm and the entrepreneur.

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was against radical implementation of such changes. "On the rare occasions when he joined in the discussion of domestic economic problems as a member of the Reich Cabinet, he limited himself to warning against panaceas and against radical breach with the economic past." Brecht, *supra* note 67, at 32. Rathenau's belief in incrementalism flowed from his understanding that innovation and tradition are in constant tension, and each has strengths and weaknesses. Incremental progress was the responsible way forward. RATHENAU, DAYS TO COME, *supra* note 67, at 104–107. As to the notion that his proposed reforms would depopulate Germany of the strong and talented, Rathenau replied: "The objection that the well-to-do will be supplied with a strong motive for emigration, is invalid. For such institutions will only develop to the extent in which they are regarded as justifiable and necessary; by slow degrees only will they reach their terminal form." *Id.* at 114. Interestingly, Veblen was also an incrementalist. *See* Rick Tilman, *Thorstein Veblen: Incrementalist and Utopian*, 32 AM. J. ECON. & SOC. 155 (1973).

78. Berle sided with the New Dealers who saw the modern corporation and its bigness as a necessary precondition to economic planning; he saw the efforts of the Brandeisians to break up the big firms and return to an idyllic past as fundamental error. Both Rathnenau and Veblen agreed. Rathenau saw the modern corporation, properly regulated, but operated by entrepreneurial executives, as an indispensable economic institution. RATHENAU, DAYS TO COME, *supra* note 67, at 119–123.

79. Though Rathenau's reform goals appeared socialistic, he rejected socialism. Henderson, *supra* note 67, at 99 ("[Rathenau was] a far-seeing reformer who would have recast capitalist society without introducing socialism.").

80. S.H. Nerlove, *Recent Writings on Profits*, 2 J. BUS. U. CHI. 361 (1929).

81. Eric Ghysels & Marc Nerlove, *The ET Interview: Professor Marc Nerlove*, 9 ECONOMETRIC THEORY 117, 119 (1993).

82. S.H. Nerlove, *Insiders and Corporate Income Streams*, 5 ACCT. REV. 153 (1930).

83. Nerlove's article is twenty-two pages in length. Specific textual reference to Frank Knight and *Risk, Uncertainty and Profit* occur on eleven of those pages. *See* Nerlove, *supra* note 80, at 362–64, 366, 368–70, 372, 374–76. Implicit references occur throughout. Significant reference is also made to the work of Maurice Dobb and C.J. Foreman.

V. THE FIVE CHAPTERS AS A RESPONSE TO KNIGHT'S ECONOMIC THEORY

A contextual interpretation suggests that a central purpose of the Five Chapters was to refute the still prominent belief that society should be organized on the basis of laissez-faire individualism and its extreme protection of private property rights. As such, the Five Chapters were a response to the then dominant account of how a free-market economy optimally allocates economic resources: Frank Knight's *Risk, Uncertainty and Profit*.[84] However, Berle made the tactical choice to use Adam Smith as a straw man and not to target Knight and Knight's analysis. Berle purported to be dissecting Adam Smith's theories and pointing out their shortcomings. In reality, he was asserting that even the most current microeconomic explanations of free markets failed as an account of a world dominated by the modern corporation.[85]

I surmise that Berle did this for four reasons. First, Berle hoped that *The Modern Corporation and Private Property* would be read widely by the educated general public, much as had been the case for his mentor William Ripley's book, *Main Street and Wall Street*.[86] While Knight and his work were then prominent in academic circles, Knight was largely unknown to the educated general public. Attacking Adam Smith would grab the attention of the educated general public,[87] while focusing on Knight would have been a pointless distraction. Second, using Adam Smith as a straw man allowed Berle to avoid getting bogged down in a heavily footnoted give and take with Knight, as had just happened in Berle's "debate" with Merrick Dodd.[88] Importantly, focusing openly on Knight would have required Berle to deal directly with Knight's powerful account of the role played by the entrepreneur, even

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84. G. J. Stigler, *A Generalization of the Theory of Imperfect Competition*, 19 J. FARM ECON. 707, 711 n. 8 (1937) ("For a more elaborate analysis of perfect competition, the classic treatment by F. H. Knight's, *Risk, Uncertainty and Profit* (1921) should be consulted.").

85. For a concise account of the transition from Adam Smith, through classical economists, to Frank Knight's analysis of both perfect and imperfect competition theory, *see* Stigler, *supra* note 84.

86. For an account of the popular impact of *Main Street and Wall Street* and Ripley's related articles, see Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247 (2010).

87. Adam Smith made the perfect straw man because he and *The Wealth of Nations* had achieved cult status with both experts and the educated general populous.

> Adam Smith's great treatise has taken, and retained a position which is unique. It has become a 'classic'. It has, unlike the mass of economic writing, established itself in the affections of the layman as well as the expert; and, unlike the mass of economic writing also, it has exchanged the fading laurels of ephemeral renown for a crown of abiding glory.

L.L. Price, *Adam Smith and his Relations to Recent Economics*, 3 ECON. J. 239, 240 (1893).

88. Bratton & Wachter, *supra* note 21, at 122–30.

within the modern corporation.[89] Berle preferred to take on Knight by scholarly sleight of hand. A standard account of laissez-faire economic theory could be attributed to Adam Smith and described in simple, folklore-like terms the content of which would be easily digestible by Berle's target audience. Berle could then make his points in similar sweeping terms. Third, Adam Smith was a central part of the myth of individualism,[90] and the myth of individualism was, in turn, the cornerstone of America's laissez-faire system of economic governance.[91] Berle's goal was to paint a new myth that would support government regulation of the modern corporation.[92] Myth-making[93] and focusing on

89. Knight has assigned the entrepreneur the central role in imperfect competition theory, that of combating uncertainty. KNIGHT, *supra* note 12, at 264–76.

90. *See* C. Eric Mount, Jr., *American Individualism Reconsidered*, 22 REV. RELIGIOUS RES. 362, 365–66 (1981); Charles L. Griswold, *Adam Smith: Conscience of Capitalism*, 15 WILSON Q. 53, 53–54 (1991); Lars Udehn, *The Changing Face of Methodological Individualism*, 28 ANN. REV. SOC. 479, 481–82 (2002).

91. For the classic account of how individualism came to control the hearts and minds of ordinary Americans from the founding of the Republic to the New Deal, see Rexford Tugwell, *The New Deal: The Rise of Business, Part II*, 5 W. POL. Q. 483 (1952). For a more theoretical account, see Rick Tilman, *Durkheim and Veblen on the Social Nature of Individualism*, 36 J. ECON. ISSUES 1104.

> Property in the beginning had no existence save as an undifferentiated element of the social structure. . . . [U]nder what circumstances did some individuals attain such identity and force of personality that property could be transferred from the collectivity to the single individual? Part of [Durkeheim and Veblen's] answer is that this occurs through the promulgation of the myth of the metaphysical prepotency of individuals and the promotion and acceptance of the myth of individualism by both self-serving individuals and the underlying population.

Id. at 1107.

92. The Berle who wrote *The Modern Corporation and Private Property* was engaged with other public intellectuals in a struggle to shape and define the myth that would form the backdrop for the presidential election of 1932 and subsequent societal efforts to respond to the economic and social catastrophe we call the Great Depression. Berle was that rare combination—a dreamer and a pragmatist. Like others working in and around the seat of power, he knew that despite the objective failure of classic liberalism and its extreme protections of the prerogatives of private property ownership, the myth of individualism still held sway in the hearts and minds of most Americans. Change could occur only by molding a new myth that would support government regulation of business and the economy. We can see Berle's efforts to develop this new myth begin to take shape in *The Modern Corporation and Private Property*, but its contours are fleshed out in *The New Individualism*, a campaign speech that Berle authored for Franklin Delano Roosevelt and in a later article, *The New Deal and Economic Liberty*. However, the new myth Berle and other progressives sought to spin could not depart sharply from the entrenched myth of individualism.

> [Americans] believed in individualism, in independence, in liberty, in high living standards, and in democracy. . . . They were sacred, although they had lost much of their meaning through abuse. Individualism was invoked to escape caring for the indigent; independence was twisted to preclude union membership; liberty had its ironic modern definition in freedom for corporations; high living standards were expected to be achieved on a wage that could be adjusted with no threat to profits. . . . Progressivism had come to imply a differing from these interpretations; it meant really believing in individualism and in liberty, not only for powerful newspaper proprietors, but for workingmen and farmers, too.

the gritty details of Knight's economic theory must have seemed incompatible projects to Berle. Finally, Berle's goal was to show that microeconomic theory had no answer to the pressing problem of the day—the Great Depression. Instead, the answer lay in government regulation. To make that case, Berle needed a simple foil to show the inadequacy of laissez-faire economic policies in the era of the modern corporation. Adam Smith provided that foil, Knight did not.[94]

The economic theory Berle attributed to Adam Smith emphasized a standard utilitarian approach to property rights—property rights should be assigned so as to ensure the maximum benefit to society.[95] Leaving each individual free to use his human and physical productive property as he saw fit, each man's pursuit of pecuniary self-interest would result in "the optimum satisfaction of human wants."[96] However, the modern corporation had made the traditional theories inadequate. The separation of ownership and control meant that there was no classic owner/entrepreneur to be motivated by potential profits. Accordingly, we can no longer base our public policies and our property laws on the economic theories that worked for the world of the individual entrepreneur.[97]

It is here that Berle played his straw-man trump card. Not only is the problem posed by separation of ownership and control endemic in the modern corporation, it is a reality that even Adam Smith realized:

Rexford G. Tugwell, *The New Deal: The Progressive Tradition*, 3 W. POL. Q. 390, 400 (1950).

93. The difficulty in making new myths is amplified by the ease with which old myths are reinforced. Berle was trying to bend this process to his ends.

> Economics, like so many other disciplines, is plagued with myths. As lecturers and as writers of textbooks, we perpetuate economic interpretations that are based not on the original source material itself, but on an oral tradition that somehow becomes codified into common knowledge. . . . Often it may be that the creation of myths serves the convenience of a ruling school of thought. The straw men fabricated in economics are sufficient to stock many revivals of *The Wizard of Oz*. By bolstering received wisdom, these myths douse the flames of heretics. Perhaps more innocently, the inertia of ideas provide myths, once established, with a longevity that could not be otherwise intentionally gained.

Craig Freedman, *The Economist as Mythmaker: Stigler's Kinky Transformation*, 29 J. ECON. ISSUES 175, 177–178 (1995).

94. However, if scholars in the field of economics had been Berle's target, then *Risk, Uncertainty and Profit* would have been the appropriate foil.

> The concept of perfect competition received its complete formulation in Frank Knight's *Risk, Uncertainty and Profit* (1921). It was the meticulous discussion in this work that did most to drive home to economists generally the austere nature of the rigorously defined concept [of perfect competition] and so prepared the way for the widespread reaction against it in the 1930s.

George J. Stigler, *Perfect Competition, Historically Contemplated*, 65 J. POL. ECON. 1, 11 (1957).

95. BERLE & MEANS, *supra* note 1, at 340.

96. *Id.* at 345.

97. *Id.* at 333–44.

> When Adam Smith talked of "enterprise," he had in mind as the typical unit the small individual business in which the owner, perhaps with the aid of a few apprentices or workers, labored to produce goods for market or to carry on commerce. Very emphatically he repudiated the stock corporation as a business mechanism, holding that dispersed ownership made efficient operation impossible. "The directors of such companies, . . ." he pointed out, "being the manager rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. . . . Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."[98]

The conclusion to be drawn from Adam Smith himself was obvious.

> Yet when we speak of business enterprise today, we must have in mind these very units which seemed to Adam Smith not to fit into the principles which he was laying down for the conduct of economic activity. How then can we apply the concepts of Adam Smith in discussing our modern economy?[99]

By this deft use of the Adam Smith straw man, Berle sought to avoid a detailed analysis of the exact disease that infected laissez-faire market theory. There was no need to take on Frank Knight's empirical argument that the modern corporation was governed as if by a classic entrepreneur. If even Adam Smith, writing before the industrial revolution, acknowledged that a very early analog of the modern corporation was an inherently unreliable vehicle for a free-market economy, then what more was there to discuss?

While this device served Berle's short-term ends well, it made possible the substantial confusion that exists today as to exactly what Berle believed and sought to achieve. The above-cited passage is often interpreted today as showing that Adam Smith understood the agency problems inherent in the relationship between shareholders and directors. Berle's reliance on this passage leaves him open to categorization as someone who believed that the main problem with the modern corporation was separation of ownership and control and that separation of ownership and control was a problem because of the consequent lack of as-

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98. *Id.* at 346 (quoting 2 ADAM SMITH, THE WEALTH OF NATIONS 229 (Everyman's Library ed.)).

99. BERLE & MEANS, *supra* note 1, at 346.

surance that the modern corporation was being operated primarily in the interests of the stockholders.[100]

Had Berle more directly and transparently confronted Frank Knight and his work, a different picture of Berle's work would have emerged. It would be clear to present day readers that Berle viewed separation of ownership and control as merely a symptom. Likewise, it would be clear that Berle was not concerned that those in control of the corporation would fail to make decisions as would a classic entrepreneur. Rather, Berle believed that the disease plaguing the economy and society was the inequality of power that existed between the controllers of the modern corporation and the rest of society, most particularly workers.[101]

Frank Knight's analysis of the free market system in *Risk, Uncertainty and Profit* would have been an ideal theoretical foil for Berle if his goal had been to address a more academic audience, because Knight's work was an attempt "to isolate and define the essential characteristics of free enterprise as a system or method of securing and directing cooperative effort in a social group."[102] As Knight too modestly summarized: "There is little that is fundamentally new in this book. It represents an attempt to state the essential principles of the conventional economic doctrine more accurately, and to show their implications more clearly, than has previously been done."[103] Thus, Knight set out not to write a new and better myth of free markets, but to write a much more detailed and accurate account of the assumptions and rules that were implicit in the grand free-market theory that traced its origins to Adam Smith.

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100. For example:

> Eugene Fama and I have been working for several years to understand the characteristics that give survival value to . . . organizations like large public corporations characterized by separation of 'ownership and control,' or more precisely, separation of the decision management and residual risk bearing functions. Scholars from Adam Smith [1776] to Berle and Means [1932] have pointed out the inconsistency of interests between managers and outside stockholders and emphasized the costs these conflicts generate.

Michael C. Jensen, *Organization Theory and Methodology*, 58 ACCT. REV. 319, 328 (1983). *See also* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 301 (1983) ("Our goal is to explain the survival of organizations characterized by separation of 'ownership' and 'control'—a problem that has bothered students of corporations from Adam Smith to Berle and Means . . . ."); Edward A. Dyl, *Corporate Control and Management Compensation: Evidence on the Agency Problem*, 9 MANAGERIAL & DECISION ECON. 21, 21 (1988) ("The agency problem caused by the separation of ownership and control in large corporations has been discussed by numerous researchers interested in the corporate form of organization, ranging from the early work of Adam Smith (1776) and Berle and Means (1932) . . . .").

101. One of the symptoms of that disease, of course, was the allocation of rewards and resources in a socially harmful manner.

102. KNIGHT, *supra* note 12, at viii.

103. *Id.* at vii.

Central to Knight's more detailed account of a free-market economy was his description of the purpose of *any* economic system, be it free-market, socialist, or communist. That purpose is the organization of economic activity.

> Organization is nearly synonymous with division of labor. In organized activity, individuals perform different tasks, and each enjoys the fruits of the labor of others. The two fundamental problems of organization are the assignment of tasks and the apportionment of rewards.[104]

> The first essential of the existing system is that it solves its two fundamental problems *together, as one.* It is individualistic; it apportions tasks through the apportionment of rewards; it is an *automatic* system, in which the interrelations of individuals are determined by self-seeking on the part of each. The foundation of the process is the private *ownership* of productive resources—a synonym for individual freedom. . . . Modern society (on the economic side) is organized on the theory that the owners of productive resources will find their best use and place them in it, because in that way they can procure the largest returns for themselves.[105]

To this point, Knight's account seems similar to Berle's recounting of the Adam Smith model, with the only new detail Knight adds being the identification of the fundamental task of economic system: the assignment of risk and reward. However, Knight then explained the criticality of how this task must be performed for the free-enterprise system to function as theorized.

> This system, therefore, involves the assumption that even in a complex organization the separate contribution of each separate productive agency can be identified, and that *free competitive relations tend to impute to each agency its specific contribution* as its reward for participation in productive activity. And to the extent that the system works at all, that we have an economic order and not chaos, this assumption must be justified.[106]

In the above cited passage lies the key assumption made by general economic theory from Adam Smith to Frank Knight: the workings of the free market will result in each worker receiving the value of his or her contribution to the firm's overall product, *as such separate contribution is determined by competitive market forces.* In the early nineteenth century world for which Adam Smith's economic theory seemed ideal, mar-

104. *Id.* at 55.
105. *Id.* at 56–57.
106. *Id.* at 57 (emphasis added).

kets worked competitively and without structural inequality of bargaining power. Products were made by time-tested methods that had been in existence for centuries. There was no concentration of productive property into a small number of hands. Consequently, what a worker could expect to receive for her services in the market would in most cases be perceived as a "fair" return for the value that she had contributed in the creation of the product.

But the world Berle and his anticipated readers lived in was one in which the laissez-faire economy, dominated by the modern corporation, was perceived as failing to deliver the promised optimal allocation of economic resources. On the production side of the economy, factories, equipment, and men stood idle; industry seemed unable or unwilling to use its capacity. On the supply side of the equation, workers were unemployed in unprecedented numbers,[107] and those who were employed earned a wage and worked in conditions that were widely viewed as unfair.[108] This failing could not be addressed within traditional economic theory, because allocating rewards *efficiently* was assumed to equate with allocating them *fairly*.

The failure of the laissez-faire system and the modern corporation to allocate rewards fairly was part of the disease Berle diagnosed, along with the associated failure to fully use the country's productive capacity.[109] The two failures worked hand-in-hand. The underpayment and poor treatment of workers created the chaos that Knight's theory predicted would occur if the system did not fairly reward workers for their contribution to the corporation's product.[110] Workers had little loyalty

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107. ARTHUR M. SCHLESINGER, JR., THE CRISIS OF THE OLD ORDER, 1919–1933, at 167–71 (1957).

108. *Id.* at 113–16. In short, something was not right with America, and everyone sensed it.

> Our peculiar history makes equality more real to us than to people in some other lands, though this has become less true in the twentieth century because of the disappearance of free land to which everyone had thought he could go and plant himself along with his crops with some assurance of security. Those to whom the traditional alternative was no longer open were learning the weakness of maintaining that such opportunity still existed when, in fact, it did not. They still believed that it *ought* to be so; but they no longer pretended so consistently that it *was* so. The more fortunate folk found, to their concern, that a deep unrest was pulsing through the less prosperous population. . . . Those who were filled with this unrest were not seeking after strange philosophies. What they wanted was what they had always been told they possessed. It had been drilled into them from their earliest years that anyone who worked and saved could "make good"—that is, could acquire competence and status. Through no fault of their own, and in spite of faithfully following all the copybook maxims, they were finding that they had no success. Sometimes they had been swindled. And they were not liking it.

Rexford Tugwell, *The New Deal: The Rise of Business, Part I*, 5 W. POL. Q. 274, 280 (1952).

109. FREDRICK L. ALLEN, ONLY YESTERDAY: AN INFORMAL HISTORY OF THE 1920'S, at 297–98 (First Perennial Classics ed. 2000) (1931).

110. SCHLESINGER, *supra* note 107, at 159–60.

and trust in their employers. Workers had little to spend and their lack of security made them reluctant to spend what they had. The chronic underutilization of factories created a large number of unemployed who had nothing at all to spend. The twin failures of under-compensation of workers and underutilization of productive capacity reinforced each other, resulting in a deflationary spiral all too similar to economic conditions experienced in America and Europe in the so-called "Great Recession" that began in 2008.[111]

The standard account of the Five Chapters describes Berle as concerned about the separation of ownership and control and its negative impact on stockholders.[112] In fact, Berle viewed separation of ownership and control as merely a symptom of the deeper problem—the concentration of power in a relatively few hands accomplished by the rise of the modern corporation and the corporate system. While he had concern for the misuse of that power to the detriment of stockholders' reasonable expectations, Berle had equal or greater concern for the detrimental effects experienced by workers, consumers, and society as a whole.

This point is made clearly in the final of the Five Chapters. Quoting Walther Rathenau, Berle describes the modern corporation as governmental in nature.[113] "The depersonalization of ownership, the objectification of enterprise, the detachment of property from the possessor, leads to a point where the enterprise becomes transformed into an institution which resembles the state in character."[114] Berle then describes the essential problem posed by, or the disease afflicting, the modern corporation and the emerging corporate system.

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111. *See* Tugwell, *supra* note 91.

> The truth of this matter was beginning to make itself felt rather widely even before 1933. People were beginning to understand that the so-called capitalist system could not continue to run as the capitalists were running it. It would simply slow down and stop. The year 1929 had looked, to many of them, like the often predicted end of the world. The abstraction and making inert of income had been ruinous. There had to be immediate, complete connection between input and output, between goods turned out and purchasing power with which to buy them. There were glaring difficulties which anyone could see. Some income was abstracted by the nonproductive or spent in nonregenerative activities; more was immobilized to provide security for favored groups; and some was being used for wasteful competition which resulted in no social benefits. These leaks, running off into stagnant, sometimes stinking pools were sufficient to stop everything occasionally, and most of the time they prevented full activity. Only once in a while did a period occur when wastes were stopped or when *purchasing power* was, for the moment, equal to *productive power*.

Id. at 498 (emphasis in original).

112. *See supra* text accompanying note 98.

113. RATHENAU, DAYS TO COME, *supra* note 67, at 121.

114. BERLE & MEANS, *supra* note 1, at 352 (quoting VON KOMMENDEN DINGEN, 121 (E. & C. Paul, trans., Berlin 1921)).

> On the one hand, [the modern corporation] involves a concentration of power in the economic field comparable to the concentration of religious power in the mediaeval church or of political power in the national state. On the other hand it involves the interrelation of a wide diversity of economic interests—those of the "owners" who supply capital, those of the workers who "create," those of the consumers who give value to the products of enterprise, and above all those of the control who wield power.
>
> Such a great concentration of power and such a diversity of interest raise the long-fought issue of power and its regulation—of interest and its protection. A constant battle has been wielded between the individuals wielding power, in whatever form, and the subjects of that power. Just as there is a continuous desire for power, so also is there a continuous desire to make that power the servant of the bulk of the individuals it affects.[115]

In this passage, Berle reveals his true concern as it relates to Knight's analysis of the underpinnings of a free-market economy and the entrepreneur's role therein. Because of the structural imbalance of power between those who control the modern corporation and the other related interests, labor is not receiving its just rewards, consumers are not receiving competitive prices, and society as a whole, including the unemployed, are not receiving the full utilization of the nation's productive property. The problem is not that those in control of the modern corporation will not ruthlessly pursue self-interest and profit. The problem is that they will. Put in terms of Knight's theory, the problem is not that the modern corporation is not managed as if by a classic entrepreneur. The problem is that it is. And the ultimate problem is that those in control of the modern corporation couple their selfish pursuit of profit with overwhelming bargaining power. As a result, the control group causes the modern corporation to expropriate a portion of the gains from trade that fairly are attributable to the contributions of labor, consumers, and society as a whole.

To Berle, the nature of the modern corporation's "profits" and the allocation of those profits are both critically important. The standard account of the Five Chapters interprets Berle as asserting that the controllers within the modern corporation expropriate rewards that should be allocated to the shareholders. However, this is a misreading of Berle. As noted in the previous paragraph, Berle viewed the modern corporation's profits as made up in part of sums that should be paid to labor and in part of sums that should benefit consumers in the form of lower prices. Con-

115. *Id.* at 352–53.

trary to the standard account, Berle believed that stockholders shared in the expropriated gains.

In *The Modern Corporation and Private Property* and related writings, Berle details the numerous legal loopholes and devices whereby the control group pays itself a share of the corporation's profits to the exclusion of the stockholders. But, importantly, the control group also pays out a substantial portion of the corporation's profits as dividends in which all shareholders benefit pro rata. Moreover, the control group shares pro rata with all stockholders the portion of the corporation's market capitalization that is attributable to expropriated profits. We can now understand why Berle argued that stockholders should only be entitled to a "sufficient" share of profits.[116] Berle suspected that non-controlling stockholders as a group actually received more from sharing a portion of the sums expropriated from workers, consumers, and society as a whole, than they would have received from pro rata receipt of all profits that would remain in a corporation that did not engage in expropriation at all. In other words, far from being a champion of shareholder primacy, Berle suspected that the shareholders were actually net beneficiaries of the great concentrations of power within the modern corporation.

It is easy to forget that Berle wrote *The Modern Corporation and Private Property* not as a matter of abstract theory, but at a time of extreme national crisis.[117] His later works show that his concerns for corporate power were not limited to times of such crises.[118] Nonetheless, his primary concern was that of his immediate experience—a time of enormous uncertainty and tremendous national and individual trauma and suffering. As Berle wrote in the last of the Five Chapters, "in time

116. "[T]he security holder must be compensated if an enterprise is to raise new capital and expand its activity just as the workers must be paid enough to insure the continued supplying of labor and the taking of the risks involved in that labor and in the life based on it. But what if profits can be made more than sufficient to keep the security holders satisfied, more than sufficient to induce new capital to come into the enterprise? Where is the social advantage in setting aside for the security holder, profits in an amount greater than is sufficient to insure the continued supplying of capital and taking of risk?" *Id.* at 342–43.

117. The tragedy of the Great Depression defies easy summarization; attempting to provide a coherent account of an event that played out each day in the shattered lives of the vast majority of Americans is a daunting literary and historical venture. For a compelling chronicle of the human stories that make up the Great Depression, see T. H. WATKINS, THE HUNGRY YEARS: A NARRATIVE HISTORY OF THE GREAT DEPRESSION IN AMERICA (Henry Holt 1999). Still, raw numbers give a backdrop against which to understand the scale of the crisis and unfolding tragedy. "[Between 1929 and 1933] Gross National Product fell by 30 per cent, industrial production virtually halved and farm prices fell by about 60 per cent. The construction industry was badly hit and investment fell dramatically. Unemployment rose from 3 per cent to around a quarter of the workforce." FIONA VENN, THE NEW DEAL 7 (Edinburgh University Press 1998).

118. ADOLF A. BERLE, JR., POWER (Harcourt Brace 1969).

of depression, demands are constantly put forward that the men controlling the great economic organisms be made to accept responsibility for the well-being of those who are subject to the organization."[119] And what they should be made to do was accept "a program comprising fair wages, security to employees, reasonable service to their public, and stabilization of business, all of which would divert a portion of the profits from the owners of passive property."[120]

Ultimately, of course, the cure for the disease that Berle and those for whom he wrote experienced could not be found in microeconomic theory. It could not be found in the entrepreneur's self-interested pursuit of profits.[121] The answer lay in applying macroeconomic policies. Only the government, through regulation, direct expenditures, and tax policy, could take the necessary steps to stabilize employment, to provide economic support to those without work, and to stimulate demand during cycles when the inherent nature of free markets produced curtailment in employment and production.[122]

Knight fully agreed with Berle on this central point. Like Berle, Knight saw that the real economy did not always work as envisioned by microeconomic theory and that periodic imbalances could only be cured by government intervention and macroeconomic theory. Moreover, he expressed these views in 1923, well before the Great Depression awakened others to the failings of a pure laissez-faire market economy.

> [A]s industry is organized under the competitive system, costs which from the social standpoint are fixed may often be avoided by the owner of the business when demand falls off, by simply leaving the productive factors, especially labor, unemployed and allowing their services to go to waste. . . . The industrial entrepreneur, who buys from other entrepreneurs partial products of large value and who hires productive services, especially labor, on short term contracts, can reduce his own costs, though not the real costs of the industry to society, by reducing output or shutting down. Undoubtedly, this fact goes far in explaining the phenomenon of the business cycle, since it involves, as Professor Clark points out, a vicious cir-

119. BERLE & MEANS, *supra* note 1, at 353.

120. *Id.* at 356.

121. As to the possibility that the problem of unemployment could be solved by reliance on the market and the voluntary action of business, Berle concluded, "I am inclined to doubt whether business will take up the slack by any process of exhortation. If it is profitable, it will do so; if it is unprofitable it will not." Adolf A. Berle, Jr., *The New Deal and Economic Liberty*, 37 ANNALS AM. ACAD. POL. & SOC. SCI. 37, 46 (1935) [hereinafter Berle, *New Deal and Economic Liberty*].

122. As Berle summarized in his first memorandum to Franklin Roosevelt in May, 1932, "Both as a matter of sound economics and decent humanity, an economic policy of the government ought to be adopted toward the restoration of individual safety." BERLE, NAVIGATING THE RAPIDS, *supra* note 2, at 33.

> cle; each curtailment reduces the demand from other products and helps to force curtailment in other industries. . . . He has placed his finger upon an inherent and far-reaching weakness in the competitive system as a method for social organization. It seems probable that any provisions which promise to deal adequately with this disharmony and to iron out the disastrous fluctuations of industry must carry us no inconsiderable way in the direction of socialism.[123]

In the end, the world views and theories of Berle and Knight, one a specialist in law, the other a specialist in economics, had much in common, unlike the vast divide that often separates those writing today who claim lineage to one or the other of these two intellectual giants.

VI. CONCLUSION

It is understandable why Berle chose not to directly engage the work of Frank Knight, then dominant in the world of traditional economic theorists. But, had he done so, the resulting synthesis would have been illuminating. Knight was no apologist for the free-enterprise system[124] and took pains to alert readers of *Risk, Uncertainty and Profit* to that fact. "The net result of the inquiry is by no means a defense of the existing order. On the contrary, it is probably to emphasize the defects of free enterprise."[125] Moreover, like Berle,[126] Knight believed that for all its shortcomings, capitalism still held promise when compared to alternative institutions.

> The fundamental fact about society as a going concern is that it is made up of individuals who are born and die and give place to others; and the fundamental fact about modern civilization is that it is dependent upon the utilization of three great accumulating funds of inheritance from the past, material goods and appliances, knowledge and skill, and morale. Besides the torch of life itself, the material wealth of the world, a technological system of vast and in-

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123. Frank H. Knight, *Economic Theory and Practice—Discussion*, 13 AM. ECON. REV. 105, 106–07 (1923).

124. "Central to Knight's disenchantment with liberalism was his understanding of the self-contradictions inherent in liberalism. Intended to build on the value of individual differences and the commitment to the search for truth and justice, liberalism was fine for a society that viewed its chief problem as organizational efficiency for the purpose of satisfying given wants. But the most important social problems are the decisions as to what we should want and what rules to use for mutual relationships, not those of organizational efficiency. For those problems, liberalism fails because the only test it offers for choosing among competing solutions are public opinion and coercion. Liberalism, therefore, undermines the social *discussion* of changes in wants and laws which it is designed to build upon." KNIGHT & EMMETT, *supra* note 28, at xix. *See also* Angus Burgin, *The Radical Conservatism of Frank H. Knight*, 6 MODERN INTELL. HIST. 513, 513–538 (2009).

125. KNIGHT, *supra* note 12, at viii.

126. Berle, *New Deal and Economic Liberty*, *supra* note 121, at 45–46.

> creasing intricacy and the habituations which men for social life must in some manner be carried forward to new individuals born devoid of all these things as older individuals pass out. The existing order, with the institutions of private property (in self as well as goods), inheritance and bequest and parental responsibility, affords one way for securing more or less tolerable results in grappling with this problem. They are not ideal, nor even good; but candid consideration of the difficulties of radical transformation, especially in view of our ignorance and disagreement as to what we want, suggest caution and humility in dealing with reconstructive proposals.[127]

It is interesting to contemplate how Berle might have set out his arguments and theories had he more directly engaged Knight and his theories. Each knew the other's discipline well. Each had a powerful intellect. In the end, what separated Berle and Knight was not so much their theories, but there interactions with the real world. While a dreamer and a thinker, time and again Berle came down from the ivory tower of theory to actively seek to mold the world into a better place.[128] In contrast, Knight was the archetypal academic.[129] A more transparent engagement by Berle of Knight's work might have resulted in Berle presenting his own theories more clearly. Moreover, it might have provoked an actual dialog between Knight and Berle—a dialog that one can imagine might have pushed the work of each man even more to the forefront of thinking about the modern corporation.

Looking to the future, what are the implications of rethinking traditional interpretations of foundational corporate law texts? One major implication has come to occupy my thinking. Corporation law scholarship for the last three decades has been dominated by the Chicago-style version of neo-classical microeconomic theory and the myth of individualism. To what extent has this dominance resulted from an ahistorical

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127. KNIGHT, *supra* note 12, at 375.

128. McCarten II, *supra* note 67, at 28, 33; McCarten I, *supra* note 68, at 22, 26–30. The following description of Walther Rathenau would have been equally apt if said of Berle: "[A]ll his life he stood with one foot in Utopia and with the other in reality—the most stable stand, perhaps, any man of genius can have, provided he knows at what time to put forward which foot. Walther Rathenau seemed to know." Brecht, *supra* note 67, at 31.

129. On Knight as a scholar's scholar:

> One great source of his influence was the purity of his devotion to the pursuit of knowledge. Frank Knight transmitted, to a degree I have never seen equaled, a sense of unreserved commitment to the truth. . . . This unswerving devotion to knowledge was exemplified and reinforced in its message to us by Knight's way of life. He was not a consultant to great or small bodies, whether public or private; he did not ride the lecture circuit; he did not seek a place in the popular press. He conducted himself as if the pursuit of academic knowledge was a worthy full-time career for a first-class mind.

George J. Stigler, *Frank Knight as Teacher*, 81 J. POL. ECON. 518, 518–519 (1973).

reading of Adolf Berle's foundational work? To what extent does the explanation lie in the fact that corporation law scholars' understanding of economics is derived largely and derivatively from the work of modern economists, rather than being grounded upon a direct engagement with the works of giants of the near past, including Frank Knight, Thorstein Veblen, and Walther Rathnau? To what extent does the explanation lie in a more general lack of historical knowledge that increasingly obscures our understanding of theorists, like Berle, whom we continue to cite?

I do not know the answer to these questions, but I have come to believe that the road forward for the academy of corporation law scholars—if we wish to play a meaningful role in the evolution of the modern corporation—will require a collective effort to recapture the past. The road forward should include the widespread reconsideration of the transformation of American society caused by industrialization, the introduction of modern modes of power transmission, transportation, and communication, and the parallel rise in power of financial capital. Further, the road forward must consider the role of mythology in shaping our governing institutions. Rather than searching for novel normative and descriptive accounts of the corporation, the road forward should be focused on developing a theory of the modern firm grounded in historical reality, and transparently built on the insights of the great giants who worked, thought, and wrote as this transformation occurred.

The study of Adolf Berle would surely be a part of such project, as would a study of Marx and Weber and Veblen. But other, now lesser-known but no less important, contributors to understanding corporations, law, and society, including Knight, should be resuscitated for modern audiences. The blueprint for future scholarship suggested by this article, then, involves a significant reorientation. The road forward should include a sustained and humble collective effort to inform the present about the largely forgotten past, so that corporation law scholarship is broadened and enriched with a deeper understanding of law, economics, and the nature of the modern corporation.